MICRO FINANCE
THE ROAD AHEAD

Delivery of small ticket loans and financial inclusion products has been a continuing challenge over the years. Several efforts have been put toward filling the gap between the bankable and the non-bankable sections through specialized services in order to bring the majority of this country's population into the mainstream financial market. These efforts have confronted various barriers including high transaction costs, non-availability of collaterals, information asymmetry, financial illiteracy, dampened demand and the lack of physical and social infrastructure, technology support etc.,

The idea of offering an opportunity to those who are excluded from the mainstream financial systems has created the concept of Microfinance. Microfinance entails providing small sums of money to groups of women without seeking any collateral security. The impact created by these small loans by way of assisting these women in initiating income generating activities and sustain their families has been endorsed by several studies. SHARE, one of the largest microfinance institutions in India, was founded by Dr. M. Udaia Kumar. As early as 1989, Dr. Kumar had started a microfinance action research program in India. The study then materialized into SHARE, which now provides services to over 2.7 million clients.

During the initial years, SHARE invested its efforts in building systems and processes tailored to the Indian market. Post establishing a strong operations model which was simple and replicable across geographies, SHARE's major constraint for growth was funding. SHARE raised its initial funding from the several developmental and financial institutions with higher margins & security clauses because its portfolio was a new asset class with no ratings, credit history, collaterals, or track record of the clients. Further, the underlying stock / receivables are spread across hundreds of villages hence attracting substantial costs to track and monitor them. Inspite of these challenges, SHARE remained undeterred and stubborn in its objective to provide its services to the underserved. SHARE's operational efficiency and success confirmed that lending to the poor is safe and trustworthy. Confidence among the stakeholders grew - in turn drawing banks and financial institutions to partner with SHARE to work toward financial inclusion in the country. To compliment these efforts, adoption of the right and sustainable legal structure

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SHARE MICROFIN LIMITED

Dr. M. Udaia Kumar

founder
SHARE & Asmitha Microfin Ltd

Although, the recent microfinance crisis has not left SHARE & Asmitha unhurt and the institutions are undergoing debt recast, the two companies have continued to serve the non A.P. States with a remarkable performance . "Our strong fundamentals have so long enabled us to run the microfinance activities in a sustainable way and have justifiable pride in our role as an agent of change and social transformation," says its founder Dr. M.Udaia Kumar.

Reminiscing his old days when he started operations in 3 different agro climatic zones of AP and slowly, over two decades, brought SHARE to the current shape and size.**"Things have turned abruptly bad for Indian Microfinance sector but not all is lost; the draft Microfinance Institutions bill is a ray of hope but what is more important is timing of its implementation,"** adds Udaia.

was essential. SHARE was the first Micro Finance Institution (MFI) in India to obtain a Non Banking Financial Company (Non Deposit) license from the Reserve Bank of India (RBI) in the year 2000.

With rest set in place, the major challenge at this stage was meeting with the equity requirements of the company. MFIs are less capitalized to maintain important parameters such as the debt equity ratio. The optimum capital structure for MFIs is 1:6 whereas for banks to lend it is 1:2 or 1:3. Further, this makes MFIs to be severely dependent on debt funding for onward lending to rural poor. Inspite of this, banks were supportive to microfinance institutions for several years based on the model and the repayment track record of MFIs and their clients. Further, the success of the model attracted equity investors in the later years, which enabled in meeting the capital requirements. The PSU banks started funding as well, with the support and favourable policy decisions by the RBI.

The idea of giving unsecured loans to a client with no proper KYC details (no address, age, education, signatures) once upon a time was considered a highly risky task and one must appreciate the initiative that has proven this mindset wrong. Growing the microfinance sector and dealing with millions of tiny borrowers with limited machinery and resources is a difficult task, which required a lot of effort in the initial years. Today, it creates exciting new possibilities for rolling out financial inclusion products and other social innovations through the infrastructure that the MFIs have created in the nook and corners of the society.

Without fundamental and technical soundness of the model; microfinance would not have been successful. Without the demonstrated success and impact, it could not have mobilized funding and investments from domestic and foreign players. We need to remember that while small may sometimes be beautiful, small is also small and it needs greater policy and advocacy support……..says Dr. Kumar.

Microfinance, as a model, facilitates financial inclusion. The microfinance sector brought 27 million households under its fold. It is associated with improvement in economic welfare of households apart from promoting women empowerment and gender equality. India has been successful in evolving a highly efficient delivery model with low cost to clients compared to the interest rates being charged in other markets across the globe. However, in the process of its evolution, the INDUSTRY ignored some of the critical aspects while concentrating on the numbers, growth, outreach, systems and processes, which was supported and welcomed by all the stakeholders.

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Though there are a lot of benefits that MFIs brought to the rural areas, these aspects have been lately suppressed and submerged with the turmoil and issues currently experienced by the industry. MFIs provide doorstep services in an organized manner. They offer timely funding support for tiny seasonal / business activities without any collateral. The loan amounts are as small as $40 to $60 with less paperwork and simple processes. MFIs offer credit, and tie up with providers of insurance and remittance services who utilize the MFI infrastructure to tap the rural markets. MFIs' infrastructure can further be utilized for financial services like savings and non-financial services- all at one stop. Further, customer relations and bonds are strong since the field officers meet the customer 50 times in a year.

There are very few such models / channels other than MFIs that offer the above unique services today to their

beneficiaries / customer segments. Microfinance assumes importance as it has proven to be an effective tool capable of addressing the huge quantum of demand and area of operations that is required today. There are numerous products offered by Banks and FIs. Most of these products are secured in terms of lending and credit. While 40% of the strata of people having access to these services today after nationalization of banks and introduction of many targets / framework by the esteemed regulators RBI, NABARD etc., 87% of the balance 60% strata of people are still struggling to get any kind of financial services - only reason being that these segments are not bankable as per the lending principles and requirements such as security, capital requirements, reliable cash flows, financial records and performance, operating efficiency etc., of the

Industry Outreach	FY 2010-11	FY 2011-12	YoY (%) +/(-)
No of Branches	11,249	9,743	(13%) ↓
No of Clients served	27.69 mn	22.56 mn	(19%) ↓
No of Staff	92,221	72,365	(22%) ↓
Disbursements	324.2 bn	199.8 bn	(38%) ↓
Loan Portfolio	200.0 bn	171.7 bn	(14%) ↓
Borrowings O/s.	144.5 bn	120.7 bn	(16%) ↓

mainstream financial institutions. In such a scenario, there is need to nurture and assist the growth of the microfinance sector. Sadly, the past two years have witnessed just the opposite.

It is 25 months since the enactment of AP MFI Act, 2010 which has curbed the access between MFIs and its borrowers in AP. Since the first and largest MFIs had originated in AP and have close to 50% of their portfolio in AP, this Act has had a severe impact on these MFIs. This crippling down of the largest MFIs has in turn affected the entire sector and created uncertainty leading to limited access to funds and further straining liquidity positions of most MFIs, including SHARE and Asmitha. At the same time, SHARE and Asmitha believe that this period has offered a unique opportunity wherein the companies revisited and strengthened their processes and systems. On a sectoral level, the last couple of years have brought much visibility to the sector leading to positive initiatives and reforms within the sector. The RBI has acknowledged the Malegam Committee Report and has already implemented several of the Committee's recommendations. MFIs

have been recognized as extended arms of banks. The sector's importance has been stressed upon and reiterated. Code of Conduct have been designed and implemented by all NBFC - MFIs. All the MFIs today share their database with each other through Credit Bureau mechanism, which is a huge task implemented with great support from specialized bureaus successfully. The tie-up will augur a new era where even a micro-client is evaluated on several credit parameters and a track is kept on issues like multiple lending, over-indebtedness etc. The recent RBI guidelines and the MF Bill to tackle the current crisis situation legitimizes the role of MFIs and clarifies that the RBI is the sole Regulator for NBFC-MFIs

WAY FORWARD:

By the very nature of its client segment and collateral free loans, the sector is exposed to risks that are particular to its lending and environment. It is highly impossible to work with this kind of client segment without the support of Government, bureaucrats and the political strata apart from the regulator - the RBI.

MFIs should relook into their operational processes and reengineer leaner, cost efficient systems. In the current environment and revenue model, it would be difficult for many MFIs to sustain their operations unless they have robust operational processes and IT systems. Consolidation and Mergers would be a solution for smaller MFIs to attain economies of scale and

reduce geographical concentration. MFIs will need to revamp their products and diversify into new ventures so that they offer a broader array of services based on a market segmentation approach. MFIs should diversify geographically and through products that create more value to clients.

From the AP crisis, the sector has learnt important lessons which should not be forgotten. MFIs will now grow at minimal and manageable levels. Focus would be on building client relationships and client retention, which would also be a way of managing multiple lending. Further, strong and in-depth role of microfinance Self Regulatory Organizations (SRO) should be strengthened in the areas of client awareness, client protection and market-watch etc., which will ease the role of the regulator. In order to address the pricing, liquidity and funding related issues, RBI may permit deposit mobilization from its own clients of MFIs that meet certain criteria (good systems, governance and technology). This will allow low cost borrowings to MFIs, which can then pass on the benefit to the clients.

"The impact of microfinance goes beyond business loans and enterprise investments. Microfinance initiatives offer more than just material benefits: they can also address issues associated with "non-material" poverty, which includes social and psychological effects that prevent people from realizing their potential" explains Dr. Udaia Kumar, Managing Director, SHARE. Reports indicate that microfinance has brought changes into the lifestyle of the unbanked segments at the bottom of the pyramid in terms of their opportunity to acquire assets, reduce dependency on moneylenders and in some cases to accumulate personal savings. The poor also learn to invest in health and education, and to meet the wide variety of other cash needs that they encounter. The infrastructure of the MFIs can be utilized for promoting savings, insurance, health and other government sponsored programs.

It would be ideal to follow a consortium approach of funding to MFIs in India. Things could have been different in Andhra Pradesh today if the funding by banks is more collective and systematic. The large quantum of funds to MFIs fuelled the unmanageable growth of the sector compromising on quality.

Finally, the central ministries should clear the regulatory uncertainty as early as possible by passing the MF Bill. Microfinance crisis in AP could become a national crisis without central regulation. Accordingly, it is crucial that the debate of the MFI Bill is fast-tracked and heard at the PARLIAMENT at the earliest.

A complete shutdown of the microfinance sector will penalize its beneficiaries more than a handful of corrupt players. Still, it is high time that the theoretical recommendations are put into practice and concrete steps are taken, to allow MFIs reach to their clients and restart the work in the state of Andhra Pradesh.

We hope this way forward approach with commitments of all the industry associates, governments, bureaucrats and banks are very much essential in order to prevent further damage to the sector.